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In the

Supreme Court of the United States

October Term, 1969

No. 61

Investment Company Institute, et al.,
Petitioners,

v.

William B. Camp, Comptroller of the Currency;
First National City Bank,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF FOR PETITIONERS

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May 22, 1970

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INVESTMENT COMPANY INSTITUTE, *et al.*,

Petitioners,

v.

WILLIAM B. CAMP, Comptroller of the Currency;
FIRST NATIONAL CITY BANK,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR PETITIONERS

OPINIONS BELOW

The opinion of the District Court (A. 206) is reported at 274 F. Supp. 624. The opinion of the Court of Appeals (A. 263) is reported at 420 F.2d 83.

JURISDICTION

The judgment of the Court of Appeals was entered on June 21, 1969 (A. 261). A timely petition for rehearing was denied on August 15, 1969 (A. 311). This Court granted a petition for writ of certiorari on March 23, 1970. *Id.;* 90 S. Ct. 1114.

The jurisdiction of this Court is conferred by 28 U.S.C. § 1254(1). The jurisdiction of the District Court was based on 28 U.S.C. § 1331.

STATUTES INVOLVED

A. The relevant portions of the Glass-Steagall Act, as amended, are as follows:

1. Section 21, 12 U.S.C. § 378

"(a) After the expiration of one year after June 16, 1933, it shall be unlawful—

(1) For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor: *Provided,* That the provisions of this paragraph shall not prohibit national banks or State banks or trust companies (whether or not members of the Federal Reserve System) or other financial institutions or private bankers from dealing in, underwriting, purchasing, and selling investment securities or issuing securities to the extent permitted to national banking associations by the provisions of section 24 of this title: *Provided further,* That nothing in this paragraph shall be construed as affecting in any way such right as any bank, banking association, savings bank, trust company, or other banking institution, may otherwise possess to sell, without recourse or agreement to repurchase, obligations evidencing loans on real estate . . . .

"(b) Whoever shall willfully violate any of the provisions of this section shall upon conviction be fined not more than $5,000 or imprisoned not more than five years, or both, and any officer, director, employee,

or agent of any person, firm, corporation, association, business trust, or other similar organization who knowingly participates in any such violation shall be punished by a like fine or imprisonment or both."

2. Section 16, 12 U.S.C. § 24

"[A national bank] shall have power—

• • •

"Seventh. To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this chapter. The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock: *Provided,* That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. . . .

As used in this section the term "investment securities" shall mean marketable obligations, evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term "investment securities" as may by regulation be prescribed by the Comptroller of the Currency. Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the

association for its own account of any shares of stock of any corporation. The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof . . . ."

3. Section 20, 12 U.S.C. § 377

"After one year from June 16, 1933, no member bank shall be affiliated in any manner described in subsection (b) of section 221a of this title with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities . . . .

"For every violation of this section the member bank involved shall be subject to a penalty not exceeding $1,000 per day for each day during which such violation continues. Such penalty may be assessed by the Board of Governors of the Federal Reserve System, in its discretion, and, when so assessed, may be collected by the Federal reserve bank by suit or otherwise."

4. Section 32, 12 U.S.C. § 78

"No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve the same time as an officer, director, or employee of any member bank except in limited classes of cases in which the Board of Governors of the Federal Reserve System may allow such service by general regulations when in the judgment of the said

Board it would not unduly influence the investment policies of such member bank or the advice it gives its customers regarding investments."

B. The relevant portions of 12 U.S.C. § 92a are as follows:

"(a) The Comptroller of the Currency shall be authorized and empowered to grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.

. . . .

"(j) . . . The Comptroller of the Currency is authorized and empowered to promulgate such regulations as he may deem necessary to enforce compliance with the provisions of this section and the proper exercise of the powers granted therein."

QUESTION PRESENTED

Whether the Comptroller of the Currency may, under 12 U.S.C. § 92a, authorize national banks to operate open-end investment funds identical to mutual funds, notwithstanding those provisions of the Glass-Steagall Act which prohibit banks from engaging in the securities business?

STATEMENT

In April 1963, the Comptroller of the Currency[1] purported to authorize national banks to operate investment funds "similar in most respects to an open-end mutual fund" (A. 265). Banks have not engaged in the securities business since 1934,[2] when the prohibitions of the depression-engendered Glass-Steagall Act went into effect.

The Comptroller's claim of authority was based on a September 1962 statute which transferred supervision over national bank trust powers from the Board of Governors of the Federal Reserve System[3] ("Federal Reserve") to the Comptroller. The Federal Reserve had exercised that authority since 1913.[4] It had at no time permitted the use of common trust funds as a device to attract "individuals primarily seeking investment management of their funds." 42 FED. RES. BULL. 228 (1956). Seven months after the transfer, the Comptroller promulgated Regulation 9[5] which

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[1] The Comptroller was then James J. Saxon; his successor is Respondent William B. Camp.

[2] The exceptions relate to underwriting certain government bonds, including obligations of the United States, general obligations of states and political subdivisions, and certain other public agency obligations. These exceptions are set forth in 12 U.S.C. § 24 Seventh. The Comptroller's attempt, in September 1963, to extend national banks' authority to deal in revenue bonds not backed by the taxing power was held to violate the Glass-Steagall Act in *Baker, Watts & Co.* v. *Saxon*, 261 F. Supp. 247 (D.D.C. 1966), *aff'd sub nom. Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d 497 (D.C. Cir. 1968).

[3] P.L. 87-722, 76 Stat. 668 (1962), 12 U.S.C. § 92a.

[4] Section 11(k) of the Federal Reserve Act of 1913, 38 Stat. 262 (1915), as amended by 40 Stat. 968 (1918) and 48 Stat. 2 (1933), formerly 12 U.S.C. § 248(d) (1958).

[5] 12 C.F.R. § 9, 28 Fed. Reg. 3309 (1963), as amended, 29 Fed. Reg. 1719 (1964), 33 Fed. Reg. 9649 (1968).

set forth conditions under which national banks might operate open-end investment funds.[6] The original Regulation did not require, however, that the moneys to be deposited in these funds were to be received by banks in trust. The Internal Revenue Service did not respond favorably to the Comptroller's request for a ruling that bank open-end investment funds would be entitled to the income tax exemption afforded common trust funds by *Internal Revenue Code of 1954* Section 584[7] until the Comptroller amended his Regulation[8] to require that sums placed in such investment

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[6] Comptroller Saxon also encouraged national banks to spread into other nonbanking activities, a number of which have since been declared unlawful. *See Baker, Watts & Co.* v. *Saxon,* note 2 *supra; Georgia Ass'n of Independent Ins. Agents, Inc.* v. *Saxon,* 268 F. Supp. 236 (N.D. Ga. 1967), *aff'd,* 399 F.2d 1010 (5th Cir. 1968). The Comptroller neither appealed the adverse District Court decision in the former case nor filed a petition for certiorari in the latter. Several other cases challenging the Comptroller's regulations are still in litigation. *Association of Data Processing Service Organizations, Inc.* v. *Camp,* 406 F.2d 837 (8th Cir. 1969), *rev'd* (on the issue of standing), 397 U.S. 150 (1970); *Arnold Tours Inc.* v. *Camp,* 408 F.2d 1147 (1st Cir. 1969), judgment vacated and remanded for reconsideration in light of the Court's decision in the *Association of Data Processing Service Organizations* case, 397 U.S. 150 (1970); petitions for certiorari from decisions upholding standing to sue in *The Wingate Corp.* v. *Industrial National Bank,* 408 F.2d 1147 (1st Cir. 1969) and *Camp* v. *The Wingate Corp., id.,* were denied, 90 S. Ct. 1110 (Mar. 23, 1970).

[7] Section 584 exempts those common trust funds maintained by a bank:

> "(1) exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian; and
>
> "(2) in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System or the Comptroller of the Currency pertaining to the collective investment of trust funds by national banks."

[8] 29 Fed. Reg. 1719 (1964).

funds must be received in trust. Rev. Rul. 64-59, 1964-1 (Pt. 1) CUM. BULL. 193.[9]

On May 10, 1965, the Comptroller granted respondent First National City Bank of New York ("Citibank") the first administrative approval of such a bank-sponsored investment fund, although Citibank's investment fund differed in many ways from the Comptroller's Regulation.[10] The Comptroller has announced that he will approve all other national bank funds in the form of Citibank's fund (A. 94).

One difference between Citibank's fund and the Comptroller's Regulation was that Citibank chose not to receive its customers' money in trust.[11] Its fund was therefore ineligible for the tax exemption provided common trust funds by *Internal Revenue Code of 1954* Section 584 under the aforementioned ruling. Citibank secured a tax-exempt status for the fund, however, by registering it with the Securities and Exchange Commission as an open-end investment company under the Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.*,[12] thereby making the fund eligible for the special tax treatment accorded to regulated investment companies by Sections 851 and 852 of the *Internal Revenue Code*. Citibank effected such registration on April 20, 1966, designating the bank as principal

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[9] *Hearings on H.R. 8499 and H.R. 9410 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 88th Cong., 2d Sess. 49 (1964), hereinafter referred to as *"1964 Hearings"; Hearing on Common Trust Funds Before a Subcomm. of the House Comm. on Government Operations*, 88th Cong., 1st Sess. 58-59 (1963), hereinafter referred to as *"1963 Hearing."*

[10] See note 51 *infra*.

[11] *Hearings on S. 2704 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 89th Cong., 2d Sess. 582 (1966), hereinafter referred to as *"1966 Hearings."* See also Wall St. J., Feb. 26, 1964, at 1, col. 5.

[12] Hereinafter referred to as the "Investment Company Act."

underwriter and also as investment advisor. Citibank also filed a registration statement with the Commission, pursuant to the Securities Act of 1933, 15 U.S.C. §§ 77(a) *et seq.*,[13] registering the fund's "units of participation" (A. 148) as securities to be issued by the fund (A. 208).

The bank also sought from the Commission certain exemptions from provisions of the Investment Company Act. The Commission approved these exemptions, expressing no opinion concerning the effect of the Glass-Steagall Act.[14] The Commission's approval was premised on its view that the fund was an entity separate and distinct from Citibank itself.[15] The Federal Reserve, on the other hand, found that the fund was not an entity separate and distinct from the bank, and on that basis held that there was no violation of Section 32 of the Glass-Steagall Act (see p. 29 *infra*) because there could be no interlocking relationship between the bank and a separate entity engaged in the securities business. 12 C.F.R. § 218.111 (1965). In that same proceeding, the Federal Reserve indicated its view that the fund's "units of participation" are securities within the meaning of the Glass-Steagall Act.[16] That finding necessarily raised issues of the fund's lawfulness under Section 21 of the Act. As the Federal Reserve pointed out:

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[13] Hereinafter referred to as the "Securities Act."

[14] SEC Investment Co. Act Release No. 4538 (Mar. 9, 1966), reproduced in *1966 Hearings*, *supra* note 11, at 81. The Commission's approval was challenged by the National Association of Securities Dealers. That case was consolidated with this one in the Court of Appeals and is here on certiorari (No. 835) from the Court's affirmance of the Commission's decision.

[15] Chairman (then Commissioner) Hamer H. Budge, dissenting, asserted that "the 'single entity' interpretation is a realistic appraisal of the true nature of the Bank's proposed operation." *Id.* at 88-89.

[16] *Id.* at 583.

> "In conclusion, the Board called attention to section 21 of the Banking Act of 1933 which, briefly, forbids a securities firm or organization to engage in the business of receiving deposits, subject to certain exceptions. However, since section 21 is a criminal statute, the Board has followed the policy of not expressing views as to its meaning. (1934 Federal Reserve Bulletin 41,543) The Board, therefore, expressed no position with respect to whether the section might be held applicable to the establishment and operation of the proposed 'Commingled Investment Account'." 12 C.F.R. § 218.111 (1965).

The Comptroller disputed the Federal Reserve's view that the fund's units of participation are securities under the Glass-Steagall Act, but sided with the Federal Reserve rather than with the Securities and Exchange Commission in viewing the fund and the bank as a single entity.[17]

The regulatory agencies involved are thus in disarray over features of the fund upon which its lawfulness under the Glass-Steagall Act depends.

Several other major banks planning to sponsor investment funds have applied to the Securities and Exchange Commission for similar exemptions from provisions of the Investment Company Act. See note 53 *infra*.[18] As of this date, however, Citibank has the only such bank investment fund in operation.

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[17] See testimony of former Comptroller Saxon. *1963 Hearing, supra* note 9, at 37, 54.

[18] The Commission has advised this Court that there "is no assurance that the Commission would reach the same judgment [as in the Citibank case] if a similar matter is again presented." Memorandum for the Securities and Exchange Commission, *National Ass'n of Securities Dealers* v. *SEC*, U.S. Sup. Ct. No. 835, October Term, 1969, p. 4.

In April 1966, Petitioners (who are described at p. 13 *infra*) brought this suit against the Comptroller, charging that Regulation 9, as implemented by approval of Citibank's fund, permitted bank activity which violates the Glass-Steagall Act. On cross motions for summary judgment, the District Court (McGarraghy, J.) declared that Regulation 9, as implemented, was unlawful (A. 256-57). The Comptroller was enjoined from authorizing additional national banks to operate such funds (A. 257), but the order requiring dissolution of Citibank's fund was stayed pending appeals filed by the Comptroller and by Citibank (A. 257) which had by then intervened (A. 258). The Court of Appeals (Bazelon, C.J., Miller and Burger, JJ.) reversed. On November 18, 1969, the judgment of the Court of Appeals was stayed by Mr. Justice Black pending resolution of these issues on certiorari.[19]

The Parties and Industries Involved

A. The Mutual Fund Business

Mutual funds came into existence in the 1920's[20] and have operated completely apart from the banking industry since passage of the Glass-Steagall Act. See p. 29 *infra*.

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[19] Citibank's November 24, 1969 Prospectus for the Fund (Attachment B, p. 12, to Form N-IR filed with SEC December 29, 1969) states:

> "A final decision adverse to either agency might require the termination of the Commingled Account and the distribution of its net assets to the Participants or the resignation of the members of the Committee who are affiliated with the Bank and the termination by the Bank of the management agreement. The Bank is of the opinion, however, that the nature of the Commingled Account's portfolio is such that the securities could readily be sold to facilitate a cash distribution without materially affecting the then net asset value per unit."

[20] *1966 Hearings, supra* note 11, at 65. See also *id.* at 97-98.

A mutual fund issues and sells securities which represent undivided interests in its investment portfolio. The proceeds are invested in accordance with each fund's stated investment policy (A. 209). Each fund is continuously changing the make-up of its portfolio and is thus continuously buying and selling securities in the market.

Mutual funds take both corporate and non-corporate forms. Securities of the latter are designated as "beneficial interests," "participating agreements," and the like (A. 209).

There is no significant trading market for mutual fund shares (A. 209). Rather, an investor desiring to dispose of his shares may at any time require the fund to redeem his proportionate share of the fund's current net asset value. This "open-end" feature distinguishes mutual funds (referred to as open-end investment companies) from the closed-end investment company, in which no right of redemption exists. A mutual fund continuously issues its securities for sale to generate the cash needed to meet these redemption obligations; otherwise, portions of the fund's portfolio might have to be liquidated. See pp. 25-26 *infra*.

To facilitate this redemption process and to establish a price at which new sales are offered, the value of a share in a mutual fund is calculated at least once a day on the basis of the market value of the securities held by the fund (A. 209). See also SEC Investment Company Act Rule 22c-1, 17 C.F.R. § 270.22c-1 (1968).

The Board of Directors of a mutual fund, elected annually by the fund's investors, governs the fund's activities. Mutual funds enter into contracts with investment advisors who furnish supervisory and administrative

services as well as advice concerning investment portfolios. The advisor's compensation is usually an annual fee based upon the total value of the assets being managed (A. 210). The traditional fee has been one-half of 1 percent, or less in the case of many funds.[21] Mutual funds also contract with a principal underwriter for the distribution of the fund's securities (A. 210). Those mutual funds which do not charge a sales commission (or sales "load") as part of the price for their securities are known as "no-load" funds (A. 210).

Mutual funds are regulated by the Securities and Exchange Commission under the Investment Company Act.[22] Under the provisions of that Act, a mutual fund is registered as open-end investment company (A. 210-11). In addition, the shares issued by the fund representing the investors' units of participation in the fund, are registered as securities with the Commission pursuant to the Securities Act. These securities are offered to the investing public by means of a prospectus, which is also filed with and subject to regulation by the Commission (A. 211).

B. The Investment Company Institute

Petitioner Investment Company Institute[23] is an association which at the time of the proceedings below represented 177 mutual funds, their 88 investment advisors and

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[21] *Report of the SEC on the Public Policy Implications of Investment Company Growth*, HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, H.R. REP. No. 2337, 89th Cong., 2d Sess. 89 (1966).

[22] *Id.* at 59-71 summarizes the basic regulatory pattern.

[23] Individual Petitioners, also members of the Institute, include Investors Diversified Services, Inc.; Investors Management Company, Inc.; Hugh W. Long & Company, Inc.; Wellington Management Company; and Wellington Company, Inc. (A. 7-9).

78 principal underwriters (A. 206). These members, which included both "load" and "no-load" funds, represent about 94 percent of all such companies in the United States and had approximately 3.5 million shareholders and assets of more than $36 billion (A. 206).

C. Commercial Banking

Commercial banks conduct the "business of banking" described in Section 16 of the Glass-Steagall Act, 12 U.S.C. § 24 Seventh—"by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing and circulating notes according to the provisions of this chapter . . . ." See *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 326-30 (1963).

As of June 30, 1969, there were 13,464 commercial banks, of which 4,700 were national banks under the supervision of the Comptroller (12 U.S.C. § 21 *et seq.*); 1,236 were state member banks of the Federal Reserve System (national banks are also required to be members under 12 U.S.C. § 222); and 7,528 were state nonmember banks with deposits insured by, and therefore subject to supervision of, the Federal Deposit Insurance Corporation under 12 U.S.C. § 1815. FED. RES. BULL., Mar. 1970, at A. 21.

D. First National City Bank

As of June 1969, respondent Citibank was the nation's third largest commercial bank (after Bank of America and Chase-Manhattan). It had as of that date total assets of $21.2 billion and deposits of $17.4 billion. POLK'S WORLD BANK DIRECTORY vi (150th ed. 1969). In 1967, Citibank had

168 branches in metropolitan New York and 241 overseas offices.[24]

The Citibank Investment Fund

The purpose and structure of Citibank's open-end investment fund are the same as those of mutual funds. Citibank uses the pooled funds tendered to it by its investors to invest in securities in accordance with the fund's stated investment policy (A. 212). Any individual may become a participant in Citibank's fund by tendering $10,000 or more to the bank under a short form which accompanies sales literature sent to bank customers (A. 158). The form designates the bank as managing agent. The promotional literature is accompanied by a copy of the prospectus for the fund (A. 170) in which Citibank describes the "opportunity for long-term growth of principal and of income" by investing in the bank's fund.

A "unit of participation" is issued to the investor which represents his share of the fund's assets. An investor may at any time require the bank to redeem his units of participation for the proportionate share of the fund's net asset value which those units represent.[25]

To facilitate the redemption process, the value of the fund's portfolio is determined not less frequently than once a week and daily valuations are made, if necessary, to cover redemptions (A. 149, 150). Cf. SEC Investment Company Act Rule 22c-1, 17 C.F.R. § 270.22c-1 (1968).

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[24] Citibank's 1967 Annual Report, pp. 16, 19, filed with the Comptroller of Currency.

[25] During the fiscal year ended August 31, 1969, Citibank redeemed over 168,000 units for $2.1 million. Annual Report of Management Investment Company of the Commingled Investment Account of First National City Bank for fiscal year ended August 31, 1969 (Form N-IR, at 3, filed with the SEC December 29, 1969).

Operation of the fund is supervised by a Committee of five persons, who occupy "a position equivalent to that occupied by the board of directors of a mutual fund" (A. 214). Pursuant to an annual investment advisory contract with the Committee, the bank provides investment services, for which it is paid a fee of one-half of 1 percent of the portfolio's net asset value. *Id.*

The bank acts as underwriter of the units of participation pursuant to a contract executed between the fund and the bank. *Id.* Sales of the units are handled by employees and officers of the bank; they are made without commission on sales, as in the case of a "no load" mutual fund.

The June 1966 prospectus for the bank's investment fund stated that the fund's investment policy "is to invest in securities which offer the opportunity for long-term growth of capital and of income . . . principally in common stocks and in securities convertible into common stocks . . ." (A. 147). The bank's six-month report to participants in the fund dated April 1967 stated that "we have invested your funds in ~~four~~ ten major industries with emphasis in the office equipment, electrical and electronics, drug and cosmetic, and airline groups" (A. 180). The bank compares the performance of its fund with the Dow-Jones Industrial Average, a method of dramatizing investment results frequently used by mutual funds (A. 180).

The Decision Below

In reversing the District Court's holding that the Citibank fund was in all substantial respects a mutual fund which a bank could not lawfully operate, the Court of Appeals issued three opinions: a per curiam opinion; an opinion of Chief Justice (then Judge) Burger, in which

Judge Miller concurred; and an opinion by Chief Judge Bazelon.

The only reference to the merits of this case in the per curiam opinion was a conclusion that the action taken by the Comptroller was "fully consonant" with the statute committed to his regulatory jurisdiction (A. 266). The court also stated that the "opinion of Judge Burger, in which Judge Miller concurs, and the opinion of Chief Judge Bazelon . . . set forth the reasons for our action . . . " (A. 266).

The opinion of the two-judge majority was devoted principally to the standing issue. It dealt briefly with the merits, treating the case as a matter of judicial review of agency expertise in defining the scope of statutory authority granted the agency and the banks by Congress (A. 309-10).

The opinion of Chief Judge Bazelon also concluded that the Comptroller's approval of Citibank's fund under Regulation 9 was lawful. Judge Bazelon found that Citibank's fund "is the functional equivalent of an open-end mutual fund" (A. 269), but noted certain differences. See p. 41 *infra*.

Judge Bazelon dealt first with the issue whether 12 U.S.C. § 92a authorized "the commingling of managing agency accounts" since that "represents a departure from past banking practice of limiting commingling to funds held by the bank in the traditional trust capacities and as trustee of a pension or profit-sharing trust." He noted that the Comptroller's Regulation "permits banks to serve multiple principals under a standard agreement vesting the bank with broad discretion to invest their money, subject to the duties and liabilities of a managing agent, and

not a trustee" and that this is "a new and free-wheeling form of fiduciary activity" (A. 271-72). He nonetheless found that the Regulation was consistent with Section 92a because "the Comptroller's Regulations, together with the protection of the customer *qua* investor afforded by the securities acts, will reasonably assure the proper exercise of this broad fiduciary power" (A. 272).

Turning next to the question of whether the fund authorized by the Comptroller violated the provisions of the Glass-Steagall Act, Judge Bazelon determined that the definitions of "security" and "underwriter" in that Act must be limited to situations in which banks risked their assets in speculative securities and "entered the business of investment banking by underwriting original issues" (A. 274). He therefore found that Sections 16, 20, 21 and 32 of the Act were inapplicable to Citibank's fund.

In summarizing his conclusions Judge Bazelon stated that:

> "The essential element in this judgment on the applicability of the Glass-Steagall Act is the fact that the securities in the Account are bought and sold for the account of customers" (A. 278).

Accordingly, he found that the Glass-Steagall Act was powerless to cope with the fact that

> " . . . an increase in [the banks'] already massive securities holdings for the account of customers has some disquieting consequences for the underpinnings of corporate accountability and competition in the economy at large . . . " (A. 278) (footnote omitted).

SUMMARY OF ARGUMENT

I

A. Citibank's open-end investment fund, which is registered as an investment company under the Investment Company Act, involves the issuance, sale, distribution and underwriting of securities, just as in the case of any other open-end investment company. Sections 16, 20, 21, and 32 of the Glass-Steagall Act prohibit banks from engaging in such securities activities. Section 21 forbids joint operation of a securities and banking business. Section 16 forbids a bank from dealing in securities except upon the order and for the account of customers. Sections 20 and 32 forbid affiliations and interlocking relationships between banks and firms engaged in securities activities. The undivided interests in an open-end investment fund regardless of how denominated are securities within the meaning of the Glass-Steagall Act. The Federal Reserve has so held in the case of Citibank's fund, just as it has held that shares of other open-end investment companies are securities within the meaning of the Glass-Steagall Act. The Federal Reserve has also ruled that, because of the redemption process, the issuance of securities constitutes a primary activity of open-end investment funds. On that basis, the Federal Reserve has consistently prohibited bank directors from serving as mutual fund directors under Section 32 of the Glass-Steagall Act. Whether or not a bank open-end investment fund is an entity separate and distinct from the bank, the fund violates one or more of Sections 16, 20, 21, and 32. The comptroller therefore has no power to authorize bank operation of open-end investment funds.

B. The legislative history of the Glass-Steagall Act shows that there had been a number of abuses inherent in

the joint operation of a banking and securities business, some of which are directly pertinent to Citibank's operation of an investment fund: (1) the bank stands to profit from the invocation of its ostensibly disinterested investment advice; (2) the relationship between the fund and the bank is in significant respects similar to that between securities affiliates and banks in the 1920's; and (3) there are potential conflicts of interest between the bank's securities and lending functions. There are other potential conflicts of interest which inhere in Citibank's operation of the investment fund—Citibank's ability to affect the value of its portfolio by precipitating a change in the prime rate of interest; Citibank's use of its portfolio transactions to secure deposit accounts of brokers; and, finally, the danger to the public interest inherent in permitting banks to gain control over still more quantities of voting securities.

C. The differences noted by the court below between Citibank's investment fund and other mutual funds are not significant. Limitations on publicizing the fund through Citibank's trust department are not meaningful in view of the size of that institution and the scope of its contacts with the public. There is no difference between the fees charged by Citibank for its investment advisory service and the traditional level of charges in the mutual fund industry. Finally, the Comptroller's regulation subjecting trust department investments to regulation by the Comptroller under "sound fiduciary principles" is irrelevant since Citibank's fund portfolio must under the Investment Company Act conform to the investment policy stated in the fund's prospectus. Positions taken by leading representatives of the banking and securities industries confirm that the Citibank fund is in all important respects identical to a mutual fund.

II

A. The "fiduciary" label affixed to Citibank's fund by Citibank and the Comptroller does not suffice to exempt it from the Glass-Steagall Act. That Act was designed to prohibit banks from abusing their fiduciary obligations.

B. 12 U.S.C. § 92a neither authorizes the operation of an open-end investment fund like the Citibank fund nor does it immunize such a fund from the Glass-Steagall Act. The obligations of other mutual funds are no less "fiduciary" than those of bank-operated funds. The Federal Reserve had refused to permit banks to operate common trust funds except as incident to bona fide or strictly fiduciary relationships and had viewed the use of such funds solely for investment purposes as not being for a bona fide fiduciary purpose. Citibank's open-end investment fund provides for automatic commingling of customers' investment sums secured on a package basis, requires no personal relationships and is otherwise devoid of the trust concepts which inhere in Section 92a.

ARGUMENT

I. THE BANK INVESTMENT FUND AUTHORIZED BY THE COMPTROLLER VIOLATES THE GLASS-STEAGALL ACT.

The Glass-Steagall Act was enacted in a period of national financial crisis. Events which had their roots in the 1929 crash caused a wave of bank failures leading up to the Bank Holiday of 1933.[26] The latter occurred in the midst of a Congressional inquiry into the role of the commercial banking industry in the collapse of the securities market and the ensuing depression.[27]

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[26] See 1933 COMPTROLLER OF THE CURRENCY ANN. REP. 1.

[27] The present dispute over the first attempted entry of a bank into the open-end investment fund business is an echo from the

Congress in 1933 determined to separate the banking and securities industries as a "preventive or prophylactic measure." *Board of Governors* v. *Agnew*, 329 U.S. 441, 449 (1947). Sections 16, 20, 21 and 32 of the Glass-Steagall Act were fashioned to achieve that result.

It has been understood for over 30 years that the Glass-Steagall Act forbids joint operation of a securities and banking business.[28] No one doubts that an open-end investment fund is engaged in the securities business; the Glass-Steagall Act has repeatedly been applied to mutual funds. See pp. 25-27, 29-30 *infra*.

Against these facts and the language of Sections 16, 20, 21, and 32 of the Act, the result reached below is remark-

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past. A primary focus of Congress' hearings in the early 1930's was on the ventures of respondent (then National City Bank of New York) into the securities business. See *e.g.*, 75 CONG. REC. 9909 (1932). See also F. PECORA, WALL STREET UNDER OATH 76 (1939, reprinted 1968):

> "The National City alone, under Mr. Mitchell's pioneering direction, came to sell not less than $1,000,000,000 of securities per year, and sometimes $2,000,000,000—aggregating the enormous total of at least $20,000,000,000 in securities which the National City manufactured, or in the manufacture of which it participated, for the ten years preceding the Senate investigation. And the National City not only 'manufactured' (the phrase is Mr. Mitchell's) these huge quantities of securities, 'suitable for public distribution'—it likewise sold these securities like so many pounds of coffee to the public. (This analogy likewise of Mr. Mitchell's.)"

[28] The prohibitions of the Glass-Steagall Act were understood at the time of the Act's passage to bar relationships between a bank and an investment fund of the type authorized by the Comptroller's Regulation. The corporate predecessor of one of the petitioners, Investors Management Company Inc., was a subsidiary of the Irving Trust Company of New York and was also an investment advisor to Irving Investors Fund C, Inc., an open-end investment fund whose shares were sold to customers of Irving Trust. The Irving Trust Company in 1934 divested itself of Irving Investors Management Company because of the passage of the Glass-Steagall Act (A. 38-40).

able: A fund which operates just like a mutual fund, which registers as an open-end investment company with the Securities and Exchange Commission under the Investment Company Act, which thereby secures the special tax benefits provided by that status, and which registers the shares it issues under the Securities Act—is somehow permitted to deny that it is engaged in the securities business under the Glass-Steagall Act. Nothing in that Act or its legislative history warrants such a strained construction of its terms.

A. Citibank Through Its Open-End Investment Fund Issues, Sells and Underwrites Securities Within the Meaning of the Glass-Steagall Act

Section 16 (together with Section 5(c), 12 U.S.C. § 335—see note 29 *infra*), provides that a member bank's authority to engage in the "business of dealing in securities and stock . . . shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account" and that the bank "shall not underwrite any issue of securities or stock . . . ."

Sections 20 and 32 apply when the securities activity is conducted by an entity separate from the bank. Section 20 prohibits affiliations between member banks and entities "engaged principally in the issue, flotation, underwriting, public sale, or distribution . . . of stocks, bonds, debentures, notes, or other securities . . . ." Section 32 prohibits officers, directors, or employees of member banks from holding like positions at the same time in enterprises primarily engaged in the issue, flotation, underwriting, public sale, or distribution of stock, bonds, or similar securities.

The most sweeping of the four provisions, however, is Section 21, which prohibits any business organization from

engaging simultaneously in commercial banking and "the business of issuing, underwriting, selling, or distributing, . . . stocks, bonds, debentures, notes, or other securities."[29]

Citibank's activities in creating, controlling and promoting its investment fund and in selling and distributing its "units of participation" to investors in the fund constitute securities activities which are barred by one or more of the foregoing provisions of the Glass-Steagall Act.

1. The central point with respect to the applicability of all these sections is that the undivided interests in an open-end investment fund—whether they are called "shares," or "units of participation," or "beneficial interests"—are securities within the meaning of the Glass-Steagall Act.

While the decision below is based on deference to agency expertise, the critical holding that the "units of participation" of Citibank's investment fund are not securities within the meaning of the Glass-Steagall Act contradicts the judgment of the Federal Reserve, the agency

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[29] Judge Bazelon incorrectly thought Section 21 lacked independent significance. In his view, its sole purpose was "to extend the prohibitions of § 16 to members of the Federal Reserve System who were not national banks" [*i.e.*, State member banks]. (A. 276). The extension of the Section 16 prohibitions to State member banks, however, was explicitly accomplished by Section 5(c) of the Act:

> "State member banks shall be subject to the same limitations and conditions with respect to the purchasing, selling, underwriting and holding of investment securities and stock as are applicable in the case of national banks under [Section 16]."

The same court had previously emphasized the independent significance of Section 21 in describing its prohibitions:

> "When Congress meant complete separation it said so, in this [Section of the] Act, in unmistakable terms. It knew what terms to use, and used them." *Agnew* v. *Board of Governors*, 153 F.2d 785, 793 (D.C. Cir. 1946), *rev'd on other grounds*, 329 U.S. 441 (1947).

charged with administering the Glass-Steagall Act since 1933. It is the Federal Reserve's view that Citibank's units of participation are securities within the meaning of the Glass-Steagall Act. *1966 Hearings, supra* note 11 at 584. Indeed, the Federal Reserve has "consistently taken the position that participations or shares in an ordinary open-end investment company or mutual fund are 'securities' for the purposes of Section 32." *Id.* at 583. The Board said that the Glass-Steagall Act is:

> ". . . sufficiently broad to comprehend securities which, while neither stocks or bonds, have attributes which cause them to be 'similar' to, or somewhat like, either bonds or stocks." *Id.* at 584.

Furthermore, while the term "securities" is not defined in the Glass-Steagall Act, the sections of the Act which refer to that term do so in a context which suggests that it should not be narrowly construed. The language of Sections 20 and 21—"stocks, bonds, debentures, notes, or other securities"—does not reflect a restrictive intent. Finally, Citibank's units are investment media and represent undivided interests in the fund's assets just as in the case of shares of garden-variety mutual funds. Citibank's units of participation are securities within any reasonable construction of that term in the Glass-Steagall Act. It therefore does not matter whether Congress can be thought to have intended the term security in the Glass-Steagall Act to have a different meaning than the same term in the simultaneously-enacted Securities Act of 1933.

2. Like considerations require construing the terms of the Glass-Steagall Act describing prohibited securities activities in accordance with their natural meaning. Thus, the prohibitions of the Act apply to mutual funds because, as the Federal Reserve has ruled, the business of issuing securities within the meaning of the Act constitutes a primary activity of such a fund:

> "It is customary for [mutual funds] to have but one class of securities, namely, capital stock, and it is apparent that the more or less continued process of redemption of the stock issued by such a company would restrict and contract its activities if it did not continue to issue its stock. Thus, the issuance and sale of its stock is essential to the maintenance of the company's size and to the continuance of operations without substantial contraction, and therefore the issue and sale of its stock constitutes one of the primary activities of such a company." 12 C.F.R. § 218.101 (1951).[30]

The redemption process likewise requires Citibank continuously to issue shares in its open-end investment fund. See note 25 *supra* and p. 35 *infra*. Citibank is therefore engaged in the issuance of securities within the meaning of Section 21 of the Act. Since that section prohibits banks from engaging in the business of issuing securities, the Comptroller has no power to authorize a bank to operate an open-end investment fund.

Citibank's investment fund also violates those provisions of Section 21 which prohibit commercial banks from selling, distributing, or underwriting securities. The prospectus for the fund (A. 146) and Citibank's sales circular (A. 170) show that the bank is selling, distributing, and underwriting[31] shares in its fund within any reasonable definition of those terms.[32]

Contrary to the views expressed by Judge Bazelon, the fact that the bank does not secure a specific distribution

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[30] Accord, 27 FED. RES. BULL. 399 (1941); 12 C.F.R. § 218.102 (1960); 12 C.F.R. § 218.107(e) (1963).

[31] Citibank is the fund's statutory underwriter (A. 142-44).

[32] Former SEC Chairman Manuel F. Cohen stated:

> "A commingled managing agency fund will operate essentially as follows: The banks will sell to their customers, and apparently to any other interested person, a participation in a pool of general securities, usually equity securities, which

profit or sales commission from its sales and distribution activity in behalf of the fund has no bearing upon the question whether the bank is engaged in underwriting, selling, distributing or dealing in securities within the meaning of the Glass-Steagall Act. The bank profits from promoting sales of units in the fund because its income is based on the size of the fund (see p. 16 *supra*). The Federal Reserve has held that a mutual fund is engaged in the public sale and distribution of its securities within the meaning of the Glass-Steagall Act irrespective of the fact that "the investment company does not derive any direct profit from the sales" of these shares. 12 C.F.R. § 218.101 (1951). Furthermore, as previously noted, the investment advisory fee is the only fee charged by "no-load" mutual funds, which no one doubts involve underwriting, selling, distributing and dealing in securities. The Senate and House Committees on Banking and Currency are also of the view that a bank open-end investment fund like that of Citibank's is engaged in the "underwriting, distribution and sales of securities" for the purposes of the banking and securities laws. S. Rep. No. 91-184, 91st Cong., 1st Sess. 10, 25 (1969); H. Rep. No. 91-387, 91st Cong., 1st Sess. 3, 9, 24 (1969); 115 Cong. Rec. H10553, H10554 (Daily ed. Nov. 5, 1969).

3. Comptroller Saxon had no power to promulgate Regulation 9 or to approve Citibank's fund because Sec-

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are selected by the bank, but which do not represent an interest in or an obligation of the bank. Such participations will be sold simply upon the basis that they represent a desirable investment since the purchaser will obtain the benefits of the investment management services of the bank, which will endeavor to procure for the purchaser both capital appreciation and income through the judicious selection of securities in which funds contributed to the account will be invested.

"It seems perfectly clear that such a participation is essentially a security, a medium of investment, and it will be sold as such." *1966 Hearings, supra* note 11, at 133.

tion 16 precludes member banks from operating open-end investment funds. That section provides that a bank "shall not underwrite any issue of securities or stock," and that any "dealing in securities and stock [by the bank] shall be limited to purchasing and selling such securities and stock, without recourse, solely upon the order, and for the account of, customers . . . ." As shown by the contemporaneous construction of this Section, it was designed to permit national banks to effect securities transactions as an accommodation to customers located in communities removed from the money centers. 1933 COMPTROLLER OF THE CURRENCY ANN. REP. 11. The Comptroller ruled in 1936 that a bank's authority under this section was limited to executing a customer's instructions:

> "In general [the statutory provision] confines the activity of a national bank in purchasing and selling securities for the accounts of customers to that of an accommodation agent, the purpose being to prevent such banks from engaging in the business of dealing in securities for profit, without limiting the service which may be rendered to customers in purchasing and selling securities upon their orders and for their accounts." Bulletin of Comptroller of the Currency, Oct. 27, 1936, quoted in 1 PATON'S BANK DIGEST 598 (American Bankers Ass'n ed. 1940).

Section 16 does not authorize a bank to create and promote an investment device and to solicit participants in the bank's open-end investment fund. The Comptroller ruled that the authority to effect a securities transaction "for the account of" a customer is limited to accommodating an existing customer and has emphasized that the customer relationship must exist independently of the particular securities transaction:

> "[The statutory provision] is to be construed as limiting the purchase and sale transactions mentioned to actual customers of the bank, which customer rela-

tionship exists independently and apart from the particular transaction in which the bank buys or sells upon the order and for the account of such 'customer,' in distinction to the relationship arising solely by virtue of the particular transaction." *Id.*

The Comptroller's office adhered to these interpretations through at least 1960. See Digest of Opinions of Comptroller of the Currency, par. 220 (April 1, 1960), 4 CCH FED. BANKING LAW ¶ 59,654.[33]

4. An affiliation or interlocking relationship between an open-end investment fund and a member bank might violate Sections 20 and 32 of the Act. If the fund and the bank are separate entities, bank officials may not serve on the fund's board of directors. The Federal Reserve has said that "ordinary open-end investment companies or mutual funds have been regarded by the Board as subject to section 32. Accordingly, the Board consistently has taken the view that interlocking relationships described in the statute between such funds and member banks are prohibited . . . ." *1966 Hearings, supra* note 11, at 585.[34]

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[33] Bank officials have recognized the limited authority of Section 16. The executive vice president of the Bank of New York said in 1962:

"Obviously, there is no problem [under Section 16] when banks act for a particular customer who owns individual securities. Orders are carried out upon the direction of the customer, and it makes no difference whether or not the motivation for the change resulted from a recommendation by the bank as investment adviser. But as soon as there is commingling, the customer no longer owns individual bonds or shares of stock but instead units in a commingled fund which the bank would manage. Any action taken would be solely by the bank for the account of the bank's investment fund and therefore only indirectly for any particular customer. Accordingly, the bank would be acting contrary to section 16 and the other pertinent provisions of the Banking Act of 1933 in operating a fund made up of participations from accounts of individuals." *1963 Hearing, supra* note 9, at 123.

[34] In 1951, for example, the Board held:

". . . it is the opinion of the Board that if such [an open-end investment] company is issuing or offering its redeem-

Thus, whatever resolution is made of the dispute between the regulatory agencies below over whether Citibank's fund is an entity separate from the bank (see pp. 9-10 *supra*), one or more of Sections 16, 20, 21 and 32 bar bank operation of open-end investment funds.

5. On the understanding that total severance was required by the 1933 Act,[35] the banking and securities industries have developed separately. Moreover, the application of the Act over the years has played a significant role in shaping the structure and competitive standing of mutual funds in the investment media market. As noted (p. 29 *supra*), mutual funds have been denied the services of all executives of commerce and industry who also served on the boards or as officers of member banks.

Congress has repeatedly had the question of the propriety of bank entry into the mutual fund business under consideration, but has thus far not seen fit to permit it.[36]

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able stock for sale, it is 'primarily engaged in the issue . . . public sale, or distribution, . . . of securities' and that section 32 of the Banking Act of 1933, as amended, prohibits an officer, director or employee of any such company from serving at the same time as an officer, director or employee of any member bank." 12 C.F.R. § 218.101 (1951). See also 27 FED. RES. BULL. 399 (1941); 12 C.F.R. § 218.107 (1963).

[35] See the contemporaneous interpretations of the Act by the Comptroller (pp. 28-29 *supra*) and by a member of the mutual fund industry (note 28 *supra*), the 1941 ruling of the Federal Reserve (note 30 *supra*). See also discussion pp. 31-32, 39-40 *infra*.

[36] Currently, Congress is considering two bills affecting bank entry into the mutual fund business. One bill, expressly authorizing bank operation of open-end investment funds, passed the Senate (S. 2224, 91st Cong., 1st Sess.; 115 CONG. REC. 13700 (May 26, 1969)); but such authorization has been stricken by the appropriate House Committee (H.R. 17333, 91st Cong., 2d Sess.; see 17 Washington Financial Report A-9 (1970)). A second bill prohibits bank holding companies and their bank and non-bank subsidiaries from selling participations in commingled agency accounts (H.R. 6778, 91st Cong., 1st Sess.; 115 Cong. Rec. H10554, H10559 (Daily ed. Nov. 5, 1969)). Previous Congressional consideration of

Under the circumstances, the long-standing separation of these two industries based on the interpretations of the Glass-Steagall Act by the Comptroller and the Federal Reserve should not now be altered except by legislation. This Court stated in parallel circumstances that "Congress is the proper agency to change an interpretation of the Act unbroken since its passage, if the change is to be made." *Blau* v. *Lehman*, 368 U.S. 403, 413 (1962). See also *Toolson* v. *New York Yankees*, 346 U.S. 356, 357 (1953); *Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d 497, 502, 504 (D.C. Cir. 1968).

B. Congress Meant to Separate the Banking and Securities Industries

The Court below refused to give effect to the terms of Sections 16, 20, 21 and 32. Judge Bazelon found the Act inapplicable because its purpose, he said, was "to protect bank depositors and the banking system from the risk of insolvency incident to widespread investment of banks' assets in speculative securities during the twenties" (A. 274). Even if it is appropriate at this late date to go behind the plain words of the Act,[37] the legislative history shows that the assumptions made over the last 30 years were not incorrect and that Sections 16, 20, 21, and 32 mean what they say.

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bank entry into the mutual fund business is reflected in *Hearings on Bank and Insurance Company Collective Investment Funds and Accounts, Investment Company Act Amendment of 1967, H.R. 14742 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 2d Sess. (1968); *Hearings on Amendment No. 438 to S. 1659 Before the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. (1967); *1966 Hearings*, *supra* note 11; and *1964 Hearings*, *supra* note 9.

[37] *Osaka Shosen Kaisha Line* v. *United States*, 300 U.S. 98, 100-01 (1937); *Matson Navigation Co.* v. *United States*, 284 U.S. 352 (1932); *Georgia Ass'n of Independent Ins. Agents, Inc.* v. *Saxon*, 268 F. Supp. 236, 238 (N.D. Ga. 1967), *aff'd*, 399 F.2d 1010 (5th Cir. 1968).

While Congress in 1933 was certainly concerned over links between commercial and investment banking, in which banks risked their own funds in purchasing securities, that was by no means its only concern.[38] As the court in *Baker, Watts & Co.* v. *Saxon*, 261 F. Supp. 247, 249 (D.D.C. 1966), *aff'd sub nom. Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d 497 (D.C. Cir. 1968), noted of the congressional investigation leading up to the passage of the Act:

> "Many other evils and abuses also arose. Congress definitely and unalterably determined to compel commercial banks to return and confine themselves to their classic time-honored functions: acceptance of deposits of money subject to withdrawal by check or other means; discount of commercial paper; and making loans."

Some of these other evils and abuses were: (1) that customers seeking disinterested investment advice from their

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[38] The Federal Reserve has over the years applied the prohibitions of the Glass-Steagall Act to bar interlocking relationships between commercial banks and a variety of organizations which were engaged in the issuance, sale, distribution or underwriting of securities in which the bank's own funds were not subject to risk:

(i) open-end investment companies, 12 C.F.R. § 218.101 (1951);

(ii) companies engaged in selling or underwriting mutual funds shares, 12 C.F.R. § 218.107(e) (1963);

(iii) investment advisers which control sales distribution subsidiaries, 12 C.F.R. § 218.107 (1963);

(iv) real estate investment companies frequently issuing a substantial amount of stock relative to their capital, 12 C.F.R. § 218.104(b) (1961);

(v) corporations in special circumstances in the process of organization and selling their own stock, 12 C.F.R. § 218.105 (1961); and

(vi) closed-end investment companies in process of organization when issuance of own stock is primary activity of company, 12 C.F.R. §§ 218.102 (1960), 218.104 (1961).

banks had been encouraged to buy securities from which the banks stood to gain; (2) that banks operated securities affiliates; (3) that there were conflicts of interest between the bank's securities and lending functions.

1. *Failure to Give Disinterested Investment Advice*

Congress was concerned over the fact that some bankers had breached their fiduciary obligations by suggesting to depositors who sought disinterested investment advice that they make purchases from which the banks stood to gain. See S. REP. No. 1455, 73d Cong., 2d Sess. 163 (1934).[39]

Senator Bulkley said in this connection:[40]

> "The banker ought to be regarded as the financial confidant and mentor of his depositors. This underlying relationship is a natural and desirable one with respect to all depositors, although the aspects of it and the

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[39] During the year in which the Glass-Steagall Act was passed, the Federal Reserve stated:

> "The Board believes that it was the intent of the Congress in enacting the provision regarding officers and directors of member banks to terminate relationships of certain kinds between member banks and dealers in securities, apparently because the Congress believed that such relationships might tend to influence the banks' credit and investment policies and their advice to their correspondent banks and other customers respecting investments in a manner which the Congress deemed to be incompatible with the public interest." 1934 FEDERAL RESERVE ANN. REP. 57.

The Congressional purpose of assuring disinterested investment advice is also reflected in the exemption added to Section 32 by the Banking Act of 1935, 49 Stat. 709 (1935), 12 U.S.C. § 78, as amended. Under that provision the Federal Reserve may grant exceptions to the Section 32 prohibitions on interlocking relationships by general regulation but only upon a showing that such exceptions will "not unduly influence . . . the advice [the bank] gives its customers regarding investments."

[40] Senator Glass asked Senator Bulkley, a member of the Committee on Banking and Currency, to explain to the Senate various portions of the Glass-Steagall Act, including those relevant here. 75 CONG. REC. 9909 (1932).

kind of advice called for will necessarily vary a great deal from the poor widow whose life savings are evidenced by a savings passbook to the great corporation requiring financial aid in the development of intricate business problems.

"Obviously, the banker who has nothing to sell to his depositors is much better qualified to advise disinterestedly and to regard diligently the safety of depositors than the banker who uses the list of depositors in his savings department to distribute circulars concerning the advantages of this, that, or the other investment on which the bank is to receive an originating profit or an underwriting profit or a distribution profit or a trading profit or any combination of such profits." 75 CONG. REC. 9912 (1932).

The sense of these remarks cannot be limited to the four types of profit which Senator Bulkley happened to mention. His concern was that a bank should profit at all by its sale of securities to a customer upon the customer's invocation of the bank's ostensibly disinterested investment advice.

Congress' aim to prevent banks from being able to sell securities to their customers from which the banks stood to profit has relevance here for three reasons: First, Citibank profits from the sale of a unit in the fund because its management fee is based on the size and value of the fund. See p. 16 *supra*. Second, the economics of operating an open-end fund like Citibank's are such that the fund must be aggressively merchandised to be viable. Former SEC Chairman William L. Cary testified before Congress:

"To make this activity economically practicable many accounts must be obtained. It is unrealistic to assume that the requisite number of accounts can be obtained without engaging in a public offering." *1963 Hearing, supra* note 9, at 8. See also *id.* at 19.

Third, the redemption process creates a pressure to sell new shares in the fund. The Affidavit of Citibank's Executive Vice President in support of its application to stay the District Court's order enjoining operation of the fund stated:

> "Even if the Commingled Account were to continue intact, without liquidation, the existing participants would be injured unless additional customers of the Bank were permitted to come in as participants. If new participants were not taken in from time to time, the Commingled Account would inevitably shrink in size as a result of withdrawals (including automatic withdrawals upon the death or incompetency of participants). As the net assets were reduced, the ratio of the operating expenses to net assets would increase" (A. 253).[41]

Indeed, the failure to replace withdrawals from the fund by selling additional shares may have a "snowballing" effect, in that each such withdrawal results in an increase of the ratio of expenses to net assets, thus adversely affecting performance, which in turn causes additional participants to withdraw. There is no equivalent set of pressures upon the bank to sell other trust department services to customers seeking disinterested investment advice. Thus, Judge Bazelon's observation that banks have equal incentive to sell other trust department services (A. 276) is incorrect. Furthermore, the situation which confronts a bank operating an investment fund when a customer seeks disinterested investment advice is in no way analogous to situations in which the family lawyer, the testator or a court asks the bank to serve as committee for an incompetent, or as guardian of a minor, or as executor, administrator, or trustee under a will.

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[41] The Affidavit also stated that the fund cost the bank $300,000 in organizational expenses (A. 251, par. 4).

2. *Securities Affiliates*

Another major area of concern was the operation by banks of securities affiliates.[42] Senator Glass stated:

> "But these affiliates, I repeat, were the most unscrupulous contributors, next to the debauch of the New York Stock Exchange, to the financial catastrophe which visited this country and was mainly responsible for the depression under which we have been suffering since. They ought to be separated, and they ought speedily to be separated, from the parent banks; and in this bill we have done that." 77 CONG. REC. 3726 (1933).

Some of these affiliates were engaged in "the operation of investment trusts which bought and sold securities purely for investment or speculative purposes" (A. 243). See *Hearings on S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 71st Cong., 3d Sess., pt. 7, at 1057 (1931). The District Court said, "These investment trusts were the equivalent of our present day investment companies" (A. 243).[43]

One of Congress' concerns over these affiliates was that they sometimes operated on funds borrowed from the parent or affiliate bank. S. REP. No. 77, 73d Cong., 1st Sess. 9 (1933). While Citibank's Prospectus announced that its fund will not borrow money (A. 148), the Comptroller's Regulation appears to permit banks to make loans to their

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[42] S. REP. No. 1455, 73d Cong., 2d Sess. 156-159 (1934); 75 CONG. REC. 9909-10 (1932). Congress did not restrict its concern to affiliates in which funds of the parent bank were risked. *Id.* at 9911.

[43] See also Galbraith, *1929 and 1969—Financial Genius Is A Short Memory and a Rising Market,* HARPER'S, Nov. 1969, at 56:

> "There was an explosion of these investment trusts in the late Twenties. If they sound suspiciously like a mutual fund, of which in these last years there has been an even more spectacular explosion, that suspicion is well founded."

investment funds, and to take back the fund's assets as security. 12 C.F.R. § 9.12(f) (1963).

Another of Congress' fears about securities affiliates was that, despite the absence of risk to the bank's funds, the public might identify the affiliate with the bank, with consequent adverse effects upon the bank in the event of a failure of the affiliate.[44] There is no reason to believe that Congress in 1933 would have had any less concern over the consequences of a failure of Citibank's fund.[45]

3. *Conflicts Between Interests of the Fund and Those of the Bank*

Congress feared that banks might allocate loan funds to companies whose securities they held (A. 274). The pressures which operate upon all mutual funds to sell new shares and avoid redemptions of outstanding shares (see pp. 26, 35 *supra*) create unique incentives on the part of banks to make loans needed by companies whose stock is held in their investment funds, in order to maintain the fund's value.

In the view of former SEC Chairman Cary, the possibility that "fund investments could be used to shore up

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[44] Senator Bulkley remarked as follows in connection with the possible consequences of the bank affiliate sustaining an underwriting loss:

> "And although such a loss would possibly not result in any substantial impairment of the resources of the banking institution owning that affiliate, still it might be suspected that large amounts might have been loaned to the affiliate; and whether that were true or not, there can be no doubt that the whole transaction tends to discredit the bank and impair the confidence of its depositors." 75 CONG. REC. 9912 (1932).

[45] The Federal Reserve reflected that concern in 1961 in observing that bank directors serving as directors of a real estate investment company ". . . might cause the company to be so identified in the minds of the public with the bank that any financial reverses suffered by the company might affect the confidence of the public in the bank." 12 C.F.R. § 218.104(c) (1961).

bank investments" represents an area "of potential conflict" between the fund's interests and those of the bank. *1963 Hearing, supra* note 9, at 11-12. A comparison of the list of Citibank's directors as of April 20, 1966 with the list of the fund's investments as of August 31, 1966 indicates that almost one-third of the fund's assets were invested in securities in companies whose officials were also directors of Citibank.[46]

The simultaneous engagement in the banking and open-end investment fund businesses creates other potential conflicts of interest which confirm the wisdom of a policy requiring their total separation. For example, Citibank is sufficiently powerful to precipitate (and thus have advance knowledge of) an increase or decrease in the prime rate of interest. Such a change in interest levels could have a dramatic impact upon the stock market generally and upon the value of securities held by the fund.

Again, banks can, by allocating brokerage payments, secure broker deposits, thus creating an incentive for turnover of the securities in the fund's portfolio. As former SEC Chairman Cary testified before Congress:

> "The fund has brokerage business to direct. We have learned that at present brokerage is often distributed by banks according to a formula which rewards those brokers who keep balances in the banks or have other business relations with the bank. This policy of the banks could lead to excessive portfolio turnover or to the fund not receiving the maximum benefit from its brokerage business." *1963 Hearing, supra* note 9, at 12.

Furthermore, the mutual fund market represents a potential for bringing under bank control substantial amounts

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[46] *Compare* A. 109-20 *with* A. 176-77.

of voting securities over and above the vast amounts now held in bank trust departments. Such acquisitions would increase the potential dangers in a situation which has already alarmed some thoughtful observers, including Judge Bazelon in the course of writing the opinion below (A. 278). See also STAFF OF SUBCOMM. ON DOMESTIC FINANCE, HOUSE COMM. ON BANKING AND CURRENCY, COMMERCIAL BANKS AND THEIR TRUST ACTIVITIES, 90th Cong., 2d Sess., vol. I, at 1-5, 18-30 (1968).[47] According to that report, Citibank's trust department, as of April 1, 1968, controlled approximately $6.4 billion in stocks. *Id.* at 49.

In any case, Congress was concerned not merely with the manifestations of the abuses revealed in the course of its investigations, but also with potential conflicts inherent in the joint operation of a banking and securities business. As Senator Bulkley explained prior to enactment of the Glass-Steagall Act:

> "It is not, of course, contended that the abuses here intimated are never avoided by the good conscience of the bankers. On the contrary, I believe they are avoided generally by good bankers. Certainly they are avoided much more often than they occur. Yet the

[47] In his letter transmitting that report, Congressman Wright Patman said that:

> "[I]t is my view that the data presented here for the first time show that the American economy of today is in the greatest danger of being dominated by a handful of corporations in a single industry as it has been since the great money trusts of the early 1900s. Through the various devices described in this study, commercial banks control the investments of billions of dollars of funds and vote large blocks of stock of major corporations in practically every important industry in the economy. These same banking institutions have gained representation on boards of directors of and serve as major sources of credit for many of these same major industrial corporations. Therefore, a few banking institutions are in a position to exercise significant influence, and perhaps even control, over some of the largest business enterprises in the nation." *Id.* at iii.

> danger is always there, and must be there as long as human nature remains human nature. . . . [W]e must surround the banking business with sound rules which recognize the imperfection of human nature [so] that our bankers may not be led into temptation, the evil effect of which is sometimes so subtle as not to be easily recognized by the most honorable man." 75 CONG. REC. 9912 (1932).

This Court characterized the Act as a "preventive or prophylactic measure. The fact that respondents have been scrupulous in their relationships to the bank is therefore immaterial." *Board of Governors* v. *Agnew*, 329 U.S. 441, 449 (1947). And, as the District Court held in this case, "this is effective legislation against temptation" (A. 245).

It is not of course incumbent on petitioners to show that the Citibank's venture into the securities business through its open-end investment fund recreates each and every abuse which led to the Glass-Steagall Act. The overall theme which emerges from the legislative history of that Act is Congress' conviction that the marriage of the banking and securities industries had led to many abuses and conflicts of interest, some of which had played important roles in causing a national disaster. It was not a time for nice distinctions between the various types of profit which banks derived from dealing in securities. Congress wanted the banks to have *no* profits from dealing in securities beyond the transactions in government bonds specifically permitted by Section 16. Congress decreed that the two industries were to be divorced. Sections 16, 20, 21 and 32 of the Act mean what they say.

C. There Are No Relevant Differences Between Citibank's Open-End Investment Fund and Other Mutual Funds

Finally, the differences which Judge Bazelon saw between Citibank's fund and any other open-end investment

fund furnish no basis for concluding that the Glass-Steagall Act applies to one but not the other. Judge Bazelon agreed with the Court's per curiam finding that the fund is "similar in most respects to an open-end mutual fund" (A. 265), but noted differences relating to (1) channels of distribution; (2) the amount of the bank's compensation; and (3) regulatory supervision by the Comptroller (A. 269-70). These alleged differences lack substance.

1. The fact that under Regulation 9 shares in a bank fund are offered and publicized only through the bank's trust department might be of some relevance to a fund sponsored by a small bank in an isolated community. The issue here, however, concerns the First National City Bank of New York, one of the world's largest financial institutions, with 168 branches in metropolitan New York, 241 overseas branches, and a staff of nearly 27,000. Citibank's 1967 Annual Report, pp. 16, 18, filed with the Comptroller of the Currency. By its own account, it serves "one out of every five families" in metropolitan New York. *1963 Hearing, supra* note 9, at 89. Its credit card customers alone number 1.4 million. Citibank's 1967 Annual Report, *supra*, p. 6. Given the size of this institution and the scope of its contacts with the public, there do not appear to be any meaningful limitations on its ability to publicize its fund.

Former SEC Chairman Cary pointed out in testimony before Congress:

> "It has been suggested that if the banks do not advertise the availability of participation in these commingled funds, no public offering will exist. However, advertising is not the only way to solicit participation.
>
> "The Bank of America with 738 branches and 25,700 employees in California, including branches in every community of modest size, can surely make the availability of the commingled managing agency account as

an investment medium known in a highly effective fashion." *1963 Hearing, supra* note 9, at 8.[48]

For the same reason, the fact that shares in Citibank's investment fund are offered and publicized only through the bank's trust department also lacks significance. Sponsorship by the bank's trust department did not preclude Citibank from sending out a sales flyer announcing its fund, in which anyone could "become a participant by completing the tear-out authorization form on page 13 of the Prospectus and forwarding it with his check to First National City Bank" (A. 170). See also Lovell, *Trust New Business, Development by Commercial Officers,* 104 TRUSTS & ESTATES 1164 (1965).

The real limitations on the content of the selling message are those provided under the Investment Company Act of 1940, which apply as well to Citibank's fund as they do to other mutual funds. See SEC Investment Company Act Release No. 2621 (Oct. 31, 1957). Comparison of Citibank's Prospectus for the fund (A. 146) with those of other mutual funds (A. 43) indicates that there are no relevant differences in the approach to the prospective investor.

2. Judge Bazelon was also mistaken in relying upon the amount of the bank's fee—one-half of 1 percent—as a basis for distinguishing Citibank's fund from other mutual funds. The traditional level of fees for investment advisory services in the mutual fund industry is also one-half of 1 percent or less. See p. 13 *supra.* See also *1966 Hearings, supra* note 11, at 61. (As previously noted, the investment advisory fee is the only fee charged by "no-load" mutual funds.)

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[48] See also *1966 Hearings, supra* note 11, at 95, 110.

Furthermore, management fees do not represent the sole possible financial benefit to banks operating such funds. As noted (p. 38 *supra*), allocation of brokerage fees arising from execution of transactions for the fund's portfolio can produce significant financial benefits, including the acquisition of broker deposit accounts. See also Fiske, *How Banks Pass Out Commissions,* THE INSTITUTIONAL INVESTOR, Dec. 1969, at 30.

3. Finally, Judge Bazelon misplaced reliance upon the factor he deemed the "most important" (A. 270), namely, that under Section 9.11(d) of the Regulation, the Comptroller has power of review over "the fund's investments to see that they are in accordance with sound fiduciary principles" (A. 270).[49]

The "sound fiduciary principles" standard is meaningful in reviewing trust department investments where the bank acts in traditional trust capacities—executor, trustee under will, guardian, etc. In such cases, it provides a basis for disapproval of investments which do not meet the needs of particular trust beneficiaries or which are made in securities not on lists approved by state officials for investment by fiduciaries or are otherwise not in accord with the "prudent man" rule. See 3 SCOTT, LAW OF TRUSTS § 227.13 (3d ed. 1967).

It may also provide a basis for review of investments which involve the bank in self-dealing or other breaches of

[49] The cited Regulation provides:

"(d) As a part of each examination of the trust department of a national bank and as provided by the Manual of Instructions for Representatives in Trusts, the Comptroller of the Currency will examine the investments held by such bank as fiduciary, including the investment of funds under the provisions of § 9.18, in order to determine whether such investments are in accordance with law, this part and sound fiduciary principles."

fiduciary obligations. The "sound fiduciary principles" standard has no meaningful application, however, in reviewing the soundness of the securities purchased for the Citibank fund portfolio since the bank is obliged under the Investment Company Act to purchase securities strictly in accordance with its stated investment policy.[50] The prospectus for Citibank's fund states that the fund's investment policy is to invest principally in those common stocks and securities convertible into common stock "which offer the opportunity for long-term growth of capital . . . in a carefully selected portfolio diversified among various industries" not more than 25 percent of which is to be "in any one particular industry. Purchases and sales of securities will be made on the basis of investment consideration and not for short-term profit" (A. 147). The prospectus further states that the fund will not invest in investment company securities, real estate investment trusts, commodity contracts, or for the purpose of exercising control of management (A. 147-48). The "sound fiduciary principles" standard of Regulation 9.11(d) has been supplanted, insofar as funds registered under the Investment Company Act are concerned, by the obligation to adhere to the terms of the fund's prospectus.[51]

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[50] Sections 8(b)(1), 8(b)(2) and 13(a)(3) of the Investment Company Act, 15 U.S.C. § 80a-8(b)(1), -8(b)(2), -13(a)(3), require that each investment fund have, announce and adhere to an investment policy.

[51] Reliance on the Comptroller's Regulation 9 is in any case open to question. The Comptroller approved Citibank's investment fund under Section 9.18(c)(5), which provides that, in addition to investments to which the detailed requirements of Section 9.18(b) apply, banks may also invest collectively funds received as fiduciary "[i]n such other manner as shall be approved in writing by the Comptroller of the Currency" (A. 268 n. 3).

The Comptroller announced on August 25, 1965, that Regulation 9 would be amended to "include a general provision authorizing

Moreover, limitations on self-dealing and protection against other breaches of fiduciary operations are provided for under the Investment Company Act and the Commission's regulations issued thereunder. See, *e.g.*, Sections 17, 21, 32-38, 15 U.S.C. §§ 80a-17, -21, -31 to -37. The Commission's inspection power—applicable to Citibank's fund as well as to other mutual funds—is provided for under Section 31 of the Investment Company Act, 15 U.S.C. § 80a-30 and the regulations thereunder.

Thus, the differences which Judge Bazelon noted between the bank's fund and mutual funds lack significance.

Furthermore, prominent representatives of both the banking and securities industries concur in the view that, notwithstanding minor operational distinctions, the bank's

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such funds" similar to Citibank's (A. 94). Judge Bazelon recognized that Citibank's fund differed from Regulation 9 and said that "there is accordingly no need to review the provisions of Regulation 9 as it was originally promulgated" (A. 268, n. 3). Thus, the restrictions of Section 9.18(b) appear to be inapplicable to funds like those of Citibank.

Citibank's fund departs from the requirements of Section 9.18(b) and other portions of Regulation 9 as well. For example, Section 9.1(g) limits managing agency accounts to those which impose upon the bank "the fiduciary responsibilities imposed upon trustees under will or deed," and Section 9.18(a)(3) requires that the commingling of managing agency accounts be pursuant to an agreement "expressly providing that such monies are received by the bank in trust." As Citibank advised the Federal Reserve, however (in seeking a favorable ruling on the applicability of Section 32 of the Glass-Steagall Act), such monies are not received in trust. See 12 C.F.R. § 218.111 (1965).

In some respects, the Comptroller's Regulation is more permissive than Citibank's prospectus. For example, Section 9.12(f) of the Regulation permits the bank to lend money to the fund, but under Citibank's prospectus the fund may not borrow money (A. 148).

In short, it is not clear what restrictions, if any, in the Comptroller's regulation limit the operation of Citibank's fund, nor is it clear whether other bank investment funds (see note 53 *infra*) will be limited by the restrictions in Citibank's prospectus where the Comptroller's regulation is more permissive.

fund authorized by the Comptroller is in sum and substance a mutual fund. Thus, in hearings on a bill which would have permitted bank funds of the general type authorized by the Comptroller's Regulations (but under restrictions different from those involved here), the President of the New York Stock Exchange advised Congress that

> "banks operating collective investment funds for managing agency accounts under the bill will be engaging in the same business conducted today by open end investment companies, commonly known as mutual funds." *1966 Hearings, supra* note 11, at 174.

The American Stock Exchange advised Congress that "the banks now wish to establish collective investment funds, offering to the public investment facilities and services not differing significantly from those of ordinary open end, 'mutual' investment funds." *Id.* at 175. The Exchange also stated that "passage of this bill would be a direct repudiation of the policy established by the Glass-Steagall Act. Banks would again be in the securities business . . . ." *Id.* at 177.[52]

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[52] In these same hearings, the Investment Bankers Association of America took the position that "a bank collective investment fund would not differ in any significant respect from an open-end investment company, popularly called a mutual fund." *Id.* at 120.

The Association of Stock Exchange Firms also stated its opposition to the bill:

> "The exchange community, as represented by the Association of Stock Exchange Firms, believes that the decision of Congress to separate the Nation's banks from the securities business still stands—that the Glass-Steagall Act should not be finessed or diluted by piecemeal legislation. We cannot help but believe that the banks would be equally vehement—and equally justified—in their opposition to the other side of this legislative coin: A bill authorizing the reentry of stock exchange member firms into major phases of the commercial banking business." *Id.* at 115.

A statement submitted by the American Bankers Association to Congress in favor of a bill to authorize commingled managing agency accounts underscores the essential similarity between Citibank's fund and other mutual funds. The Association representative stressed that the bill would preclude banks from making daily valuations—a "prohibition [which] places a significant restraint on admissions and withdrawals, so important to the successful operation of a mutual fund." *1966 Hearings, supra* note 11, at 39. See also *id.* at 45-46. The Comptroller, however, permitted Citibank to make daily valuations. See p. 15 *supra.*

The American Bankers Association also stressed the limitation in the proposed legislation which would have prohibited investors from participating in the fund unless their initial investment was at least $10,000. *1966 Hearings, supra* note 11, at 39, 46. The Comptroller's regulation, however, has no minimum amount prescribed. Furthermore, there are several applications on file with the Securities and Exchange Commission by banks proposing to sponsor funds which provide for minimum investments of $5,000.[53] One national bank is "actively considering" a fund providing for a $2,500 minimum investment. Brief for the Comptroller in Opposition to Certiorari, at 6 n. 6.

Former SEC Chairman Cohen said that bank-sponsored commingled funds are "essentially the same as mutual

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[53] See, *e.g.*, First Minneapolis Growth Fund (File No. 2-36569-1); First Minneapolis Income Fund (File No. 2-36570-1); Continental Bank Growth Fund, Chicago (File No. 2-36450-1); Continental Bank Security Fund, Chicago (File No. 2-36449-1); First Chicago Growth Fund (File No. 2-35935-1); First Chicago Investment Fund (File No. 2-35934-1); Northwestern Investment Fund, Minneapolis (File No. 2-35828-1); C & S Investment Fund, Atlanta (File No. 2-35003-1).

funds." *Hearings on H.R. 14742 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 2d Sess., at 122 (1968). Former SEC Chairman Cary said that the Comptroller's regulation "permits banks to engage in what is hardly distinguishable from the mutual fund business." *1963 Hearing, supra* note 9, at 7. The chairman of the Federal Deposit Insurance Corporation stated that the Comptroller's regulation authorizes "bank entry in the mutual fund business." *1966 Hearings, supra* note 11, at 276. See also S. REP. No. 1351, 90th Cong., 2d Sess. 10-12 (1968).[54]

Therefore, Citibank's fund is a mutual fund, and the Comptroller, by implementing his Regulation 9 to authorize that fund, has in fact authorized the bank to engage in the issuance, sale, distribution and underwriting of securities, each of which activities violates the Glass-Steagall Act.[55]

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[54] The 1969 Annual Report of the First National City Corporation (a one-bank holding company formed in 1968), p. 16, filed with the SEC February 12, 1970, described this suit as one which seeks to block bank operation of "mutual-type funds."

[55] It follows that the Court of Appeals was in error in holding that the question presented was one involving the review of an exercise of agency expertise. Such a standard of review is inapposite in cases asserting that administrative action is not authorized by statute. See *First National Bank* v. *Dickinson*, 396 U.S. 122 (1969); *NLRB* v. *Brown*, 380 U.S. 278, 292 (1965); *NLRB* v. *Insurance Agents' International Union, AFL-CIO*, 361 U.S. 477, 499-500 (1960); *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, 677-78 (1954); *Elgin, Joliet & Eastern Ry.* v. *Benj. Harris & Co.*, 245 F. Supp. 467, 472 (N.D. Ill. 1965). As this Court has stated:

> "Administrative determinations must have a basis in law and must be within the granted authority. . . . An agency may not finally decide the limits of its statutory power. That is a judicial function." *Social Security Board* v. *Nierotko*, 327 U.S. 358, 369 (1946) (footnote omitted).

II. A BANK MUTUAL FUND IS NOT IMMUNE FROM THE GLASS-STEAGALL ACT SIMPLY BECAUSE IT IS OPERATED BY THE BANK'S TRUST DEPARTMENT.

Absent exemption from the Glass-Steagall Act, banks cannot directly or indirectly engage in the securities business without violating one or more of Sections 16, 20, 21 and 32. It is implicit in the decision below, particularly in the opinion written by Judge Bazelon, that such an exemption from Glass-Steagall arises in favor of securities dealings by banks when conducted under the aegis of their trust departments. Such a holding can only be justified if: (1) the Glass-Steagall Act does not apply to securities dealings by a bank when the bank has a "fiduciary" obligation to its customer; and (2) 12 U.S.C. § 92a (which provides for the granting of trust powers by the Comptroller to national banks) authorizes the Comptroller to grant exemptions from the Glass-Steagall Act. Neither proposition is valid.

A. No Immunity Arises From the Mere Fact That the Bank Has a "Fiduciary" Obligation Towards Investors in Its Fund

Nothing in the Glass-Steagall Act warrants the conclusion that it is inapplicable here simply because a "fiduciary" label has been affixed to the bank's fund by the Comptroller and Citibank.[56] Indeed, it was the breach by banks of their "fiduciary" obligations which caused Congress to pass the

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[56] The provision in Section 16 which permits banks to buy and sell securities "for the account of customers" has nothing to do with a distinction between securities dealings conducted in a fiduciary capacity and those conducted in other banking capacities. The purpose of that provision was simply to allow banks to accommodate existing customers by executing their stock market orders. See pp. 27-29 *supra*.

Glass-Steagall Act in the first place. The Report of the Committee on Currency and Banking stated:

> "Commercial banks found a fertile field among [their] depositors for purchasers of security issues which their investment affiliates were sponsoring. These banks, violating their fiduciary duty to depositors seeking disinterested investment counsel from their bankers, referred these depositors to the affiliates for advice." S. REP. No. 1455, 73rd Cong., 2d Sess. 163 (1934).

The Report further found

> "A great many of these evils [disclosed in Senate Subcommittee Hearings] were, however, attributable to the utter disregard by officers and directors of commercial banks and investment affiliates of the basic obligations and standards arising out of the fiduciary relationship extending not only to stockholders and depositors, but to persons seeking financial accommodation or advice. The hearings disclosed, on the part of many bankers, a woeful lack of regard for the public interest and a proper conception of fiduciary responsibility." *Id.* at 185.

Thus the Glass-Steagall Act was meant to reach bank activities even if conducted in the exercise of its fiduciary responsibility.

B. 12 U.S.C. § 92a Neither Authorizes Regulation 9 Nor Confers Immunity From the Glass-Steagall Act

Section 92a does not authorize the Comptroller to immunize conduct which would otherwise violate the Glass-Steagall Act. The statute simply concerns the granting of corporate authority to act in a trust capacity—"as trustee, executor, administrator, registrar of stocks and bonds,

guardian of estates, assignee, receiver, committee of estates, lunatics, or in any other fiduciary capacity in which State banks . . . are permitted to act under the laws of the State in which the national bank is located.[57] Like any other grant of corporate authority conferred by statute or by charter, it cannot be escalated into a license to violate the provisions of substantive law. For example, it is clear that the authority granted national banks to merge under 12 U.S.C. § 215a does not immunize bank mergers from prosecution under the antitrust laws. See *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 350-52 (1963).

Section 92a does not explicitly confer any immunity from the Glass-Steagall Act. Nor is there a repugnancy between the two statutes which requires reconciliation here. Compare *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963).

The term "fiduciary" covers so many activities (*e.g.*, the practice of law) which are far removed from traditional trustee services that Congress cannot reasonably be deemed to have given the Comptroller authority to allow bank trust departments to engage in any activity which he or a State[58] might conclude involves "fiduciary" obligations. A mutual fund's obligations to its shareholders are no less "fiduciary" than those of the Citibank fund.

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[57] While Section 92a authorizes the Comptroller to grant trust powers to national banks in states where similar powers are granted to state banks, the fact that New York would now authorize its banks to engage in such activity has no bearing on the lawfulness of the Comptroller's action under the Glass-Steagall Act, since state banks are likewise subject to the prohibitions of the Glass-Steagall Act.

[58] Cf. 19 Fed. Res. Bull. 188 (1933):

"The fact that corporate fiduciaries in at least one State are permitted by State law to invest trust funds collectively in real-estate mortgage pools in this manner was brought to

Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. 46 (1940). See also H. Rep. No. 2639, 76th Cong., 3d Sess. 10 (1940); S. Rep. No. 1775, 76th Cong., 3d Sess. 12 (1940). There is no basis for an inference that Congress meant the Glass-Steagall prohibitions to give way before whatever powers labeled "fiduciary" are dispensed by the Comptroller under Section 92a.

Indeed, other legislation suggests that Congress would not have regarded Citibank's commingling of managing agency accounts as a "fiduciary" activity under Section 92a. Thus, in Section 584 of the *Internal Revenue Code*, Congress exempted from taxation common trust funds maintained by a bank in its capacity as "trustee, executor, administrator, or guardian." This would not include Citibank's commingled managing agency fund. See pp. 7-8 *supra*. Similarly, Section 3(c)(3) of the Investment Company Act, 15 U.S.C. § 80a-3(c)(3), exempted "any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator or guardian . . ." but again, this would not include Citibank's commingled managing agency fund. Former SEC Chairman Cary testified in House hearings in 1963 that the basis for this distinction was "the assumption that the traditional common trust fund as circumscribed by the Federal Reserve Board could be used only for bona fide fiduciary purposes and not as a vehicle for general investment by the public." *1963 Hearing, supra* note 9, at 4.

The promotion and sale by a bank of an investment fund in form composed of commingled managing agency ac-

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the board's attention when it was considering this question; but the board held that this did not authorize national banks to engage in such practices."

counts is far removed from the trust concepts of Section 92a. As Chief Judge Bazelon noted, this is a "new and free-wheeling activity" (A. 272). The Federal Reserve, which supervised trust powers of national banks from 1913 until 1962, consistently warned against abuse of the authority to employ common trust funds, strictly limiting them to trusts created for "bona fide" or "strictly fiduciary purposes." 24 FED. RES. BULL. 4-5, 10 (1938). The Board stated that it was "improper" for a bank to use "the common trust fund as a medium attracting individuals primarily seeking investment management of their funds." 42 FED. RES. BULL. 228 (1956). See also 26 FED. RES. BULL. 393-94 (1940); 41 FED. RES. BULL. 142 (1955).

The factor which distinguishes accepted trust activity from a public investment medium such as a mutual fund is the element of continuing personal attention to the customer's individual needs. As former SEC Chairman Cohen stated:

> "The commingling of managing agency accounts represents a departure from traditional banking practice . . . . Previously, the relationships between the bank and the persons for whom it acted arose from individually negotiated trust agreements, individually negotiated managing agency accounts, or similar arrangements, and the commingled fund itself was never presented as an investment medium to the general public. The proposal to [authorize banks to operate mutual funds] removes the element of individualized relationships and replaces it with a standard investment package offered on an identical basis to all comers." *1966 Hearings, supra* note 11, at 136-37.

A similar distinction was drawn by Reese Harris, Vice President, Trust Division, American Bankers Association, whose testimony before Congress indicated that a bank collective fund for managing agency accounts would lack

sufficient "fiduciary" characteristics to distinguish it from a mutual fund unless:

(1) the managing agency accounts come into existence prior to the time that the bank establishes its collective fund. "By contrast," Mr. Harris noted, "a person who buys shares in a mutual fund does so exactly as he buys shares in any other corporation"; and

(2) the bank has discretion whether to commingle any part of the customer's funds, so that there can be no "possibility of a managing agency contract providing for the direct or automatic investment of management agency account in a collective fund." *1964 Hearings, supra* note 9, at 87, 88.[59]

Citibank's fund fails on both tests set out by Mr. Harris. The investor creates the managing agency as he tenders his money, exactly as he buys shares in a mutual fund. Second, there is no exercise of discretion by a trust officer and no element of individualized relationship. The only information required from the participant in the tear-out

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[59] Former Comptroller Saxon has emphasized that the bank's retention of discretion in determining whether to commingle funds is a controlling element of a true fiduciary relationship, even for managing agency accounts:

> "Now, in all of these funds, it is the bank itself which exercises the discretion as to whether the funds of particular accounts shall go into a common trust fund.
>
> "In our own regulation, for example, the investment discretion makes the relationship an agency trust, rather than simply an agency. It is the discretion exercised by the bank in putting a trust customer's funds either into a common trust fund or elsewhere, which is significant.
>
> "People, too, aware that common trust funds exist, in entering into a fiduciary relationship may request or otherwise provide for collective investment as a permissible form of investment.
>
> "Fundamentally, though, the discretion lies in the bank." *1963 Hearing, supra* note 9, at 50.

authorization form is his name, address and social security number (A. 158). All of the funds so tendered by the investor are directly and automatically invested in the collective fund. The fund's Prospectus so requires (A. 147), and the Affidavit of City Bank's executive vice president shows that the bank at no time weighs the possibility of not investing the customer's money in the commingled account (A. 197). As Judge Bazelon noted of the bank's claim that it gave individual attention to each investor's particular needs:

> "The Bank's affidavit states that it will accept the customer's money if it is satisfied that the Account's investment policy is suited to his needs. It appears from the mailing to 'valued customers,' however, that they will be acceptable if they read the invitation, with its caveats, and the prospectus and send in the tear-out authorization with $10,000" (A. 275, n. 9).

In short, the operation by a bank trust department of an open-end investment fund like Citibank's is devoid of the personal trust concepts of Section 92a and is indistinguishable from a mutual fund. There is accordingly no basis for inferring that Congress intended either to authorize bank operation of such funds under 12 U.S.C. § 92a or to grant exemptions in their favor from the Glass-Steagall Act.

CONCLUSION

The judgment of the Court of Appeals should be reversed and the cause should be remanded to that court to enter judgment affirming the judgment of the District Court.

Respectfully submitted,

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